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IN THE

Supreme Court of the United States

October Term, 1965
No. 140

ISADORE BLAU,

Petitioner,

vs.

DAVIS FACTOR; LOUIS FACTOR; MAX FACTOR, JR.; SIDNEY FACTOR; CHESTER FIRESTEIN; MAX FIRESTEIN; FREDA F. SHORE; ANNA FACTOR; DORIS FACTOR; DOROTHY FACTOR; CECILIA FIRESTEIN; and MAX FACTOR & Co.,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Brief for Respondents, Davis Factor; Louis Factor; Max Factor, Jr.; Sidney Factor; Chester Firestein; Max Firestein; Freda F. Shore; Anna Factor; Doris Factor; Dorothy Factor; and Cecilia Firestein, in Opposition.

Opinions Below.

The District Court did not render any opinion in the action. Its Findings of Fact and Conclusions of Law appear at R. 137. The opinion of the Court of Appeals for the Ninth Circuit [R. 155, App. of Petition, p. 3] is reported at 342 F. 2d 304.

Jurisdiction.

The jurisdictional requisites are adequately set forth in the Petition.

Question Presented for Review.

"Whether the exchange of shares of one class of stock for another of the same corporation, pursuant to a right of exchange granted by the issuer's charter, constitutes a 'purchase' of the new shares within the meaning of Sections 16(b) and 3(a)(13) of the Securities Exchange Act of 1934, 15 U.S.C. Sections 78p(b) and 78c(a)(13) where:

(a) As concurrently found by two courts below, the investment risk, marketability and market price of both classes are identical;

(b) The rights and privileges of both classes are substantially identical, the sole exception being that the Board of Directors *may* but *need not* declare a lesser dividend on the class surrendered than on that received in the exchange; and

(c) Where, as a result, the two lower courts have found that the making of the exchange, and its timing, were simply irrelevant to the use of inside information."

Statutes and Regulations Involved.

Pertinent provisions of the Securities Exchange Act of 1934, Sections 16(a), 16(b) and 3(a)(13), 15 U.S.C. Sec. 78p(a), p. 46 Cum. Sup., Sec. 78p(b), p. 322, and Sec. 78c(a)(13), p. 235, are set forth in the App. to the Petition, p. 1.

Statement of Facts.

A. The Material Pleadings.

In compliance with the demand dated March 5, 1963 of petitioner Blau [R. 9], Max Factor & Co. ("the company" herein) on April 8, 1963, filed its complaint in the court below (No. 63-414 TC), for the purpose of obtaining a judicial determination whether the transactions referred to in Blau's demand gave rise to liability under Section 16(b) and, if so, for the recovery of any profits realized by certain respondents from any purchase and sale of the equity securities of the company within any period of less than six months [R. 1]. Named as defendants were Blau and, in accordance with his demand, the seven officers or directors of the company referred to therein [R. 1].

After having been served with the company's complaint, petitioner Blau filed a separate action, involving the identical transactions, in the United States District Court for the Southern District of New York, naming as defendants the company and the eleven individual respondents[1] [R. 45]. On motion of respondents, that action was transferred under the provisions of 28 U.S.C. §1404(a) to the United States District Court for the Southern District of California [R. 101].

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[1]The seven male respondents are directors and/or officers of the company; three of the female respondents are neither directors, officers nor owners of ten per cent of the listed securities of the company but are wives of three of the directors; the fourth female respondent is neither a director, an officer, a ten per cent owner of listed securities of the company, nor a wife of a director or officer or such a shareholder. However, in view of petitioner's claim in the District Court that all eleven respondents should be treated as a unit for Section 16(b) purposes, respondents stipulated solely for the purpose of the motions for summary judgment that all eleven respondents were "insiders" to whom Section 16(b) would apply if the transactions were within the scope of the section and were not exempt by reason of Rule 16b-9 [R. 138].

By his answer and cross-claim in the first action, Blau asserted precisely the same claims against respondents as were set forth in an amended complaint by him in the second action [R. 19, 28]. After the filing of answers and supplemental answers to the complaints and cross-claims, the individual respondents filed motions for summary judgment dismissing the complaints and cross-claims. The actions were consolidated, without objection, for the hearing and determination of these motions [R. 137]. The motions were granted on January 27, 1964, and findings of fact, conclusions of law, and judgment were filed and entered on January 28, 1964 [R. 137, 143].

The trial court determined [R. 143, 144] (i) that the challenged transactions did not constitute "purchases" within the purpose and meaning of Section 16(b), (ii) that the individual respondents did not "realize" any profit from any "purchase and sale" of any stock of the company within any period of less than six months, and (iii) that, in any event, the transactions were exempt by reason of the provisions of Rule 16b-9 of the Rules of the Securities and Exchange Commission.

The Court of Appeals affirmed as to points (i) and (ii), but expressly stated that "since we decide that §16(b) was in any event inapplicable, we do not consider the applicability and validity of Rule 16b-9" [App. of Petition, p. 6].[2]

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[2]The Securities and Exchange Commission adopted Rule 16b-9 exempting transactions of the type involved in the present case, pursuant to express authority given the Commission in Section 16(b), which reads, in part, "* * * This subsection shall not be construed to cover * * * any transaction or transactions which the Commission by rules and regulations *may exempt as not comprehended within the purpose of this subsection.* [italics added]" [App. to Petition, p. 2]. In its brief as amicus curiae before

B. The Material Facts.

The individual respondents are the sons and daughters of the founder of the company, Max Factor, Sr. and their close relatives. Prior to 1946, the stock of the company was wholly owned by the Factor family. In 1946, the company first sold its stock to the public. At that time the Common Stock was the only existing class of stock [R. 138].

Shortly thereafter the family members proposed a stock structure which would permit a maximum dividend yield to the nonfamily public stockholders while at the same time permitting the company to retain a large proportion of its earnings to finance the expected expansion of the company [R. 108-109]. In order to accomplish this, the family members were willing to grant to the Board of Directors the right to declare and pay a higher dividend to the public stockholders than it would declare and pay to the family stockholders. This plan was effectuated in 1947 by the creation of Class A Stock by amendment to the company's Certificate of Incorporation. All the then outstanding stock was Common Stock and each holder had the right to exchange his Common Stock for a like number of shares of Class A Stock at any time.

The public stockholders made the exchange soon after the Class A Stock was created, but the family

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the Court of Appeals the Commission argued in support of the District Court's judgment (which was affirmed) and stated that the mere adoption of Rule 16b-9 did not imply that the Commission believed the transactions in the present case are within Section 16(b). "Rules are often adopted as a precaution against possible court decisions to the contrary." Brief of Securities and Exchange Commission as amicus curiae page 5.

members continued to hold their shares as Common Stock for many years. [R. 13, 108-109, 78]. Since 1957, the rights and privileges of the Common Stock and of the Class A Stock of the company are as set forth in Article Fourth of its Certificate of Incorporation[3] [R. 139].

It is significant that the only purpose for the creation of the Class A shares was to permit, but not require, the Board of Directors to declare a lesser (or no) dividend on the Common shares than on the Class A shares. [R. 108-109]. That this is the only difference in the rights and privileges of the two classes of shares is manifest from a reading of Article Fourth (App.). In all other respects the rights and privileges of the two classes are precisely the same. The shares of both classes have equal voting powers. The shares of both classes have equal rights on liquidation. None of the shares is subject to redemption. All of the shares are freely transferable. [R. 13, 80, 138-139]. Indeed, that there are no differences between the two classes of shares is demonstrated by the fact that the Board of Directors may adopt a resolution by virtue of which all outstanding Class A shares shall become shares of Common Stock on a share-for-share basis. [R. 80]. At all times, the company has consistently treated the Common Stock and the Class A stock as if they were shares of a single class of common stock in report-

[3]The provisions of Article FOURTH of the Certificate of Incorporation are set forth in the Appendix.

ing its earnings per share in press releases, in annual reports to shareholders, in its prospectuses, and its reports to the Securities and Exchange Commission. [R. 13].[4]

On the basis of the foregoing facts, the trial court found that the only difference between the rights and privileges of the Common Stock and of the Class A Stock was that the Board of Directors could declare a lesser or no dividend on the Common than was declared or paid on the Class A.

On March 14, 1961, the individual respondents[5] exchanged an aggregate of 200,000 shares of Common Stock which they had owned for many years[6] for 200,000 shares of Class A Stock of the company in accordance with the provisions of the company's Certificate of Incorporation which gave them the right at any time to make such exchange. Such exchanges were made by each individual respondent in contemplation of a public sale of the Class A shares acquired in

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[4]The preceding analysis in the text of the characteristics of the two classes of stock here involved is material to determine whether they are so substantially identical that the exchange of Common for Class A shares followed by the sale of the Class A shares is merely an alternative method of selling the Common. (*Infra*, p. 15).

[5]Not including Chester Firestein, who made similar exchanges of Common for Class A shares and later sold Class A shares [R. 139]. These differences are immaterial to any of the issues presented by the petition.

[6]Three respondents acquired said Common shares in 1929 [R. 71, 75, 77]; one in 1929 and 1938 [R. 67]; one in 1933 [R. 69]; one in 1938 [R. 72]; one in 1946 [R. 74]; and four prior to 1956 [R. 68, 70, 73, 76]. Thus respondents had held this Common Stock for a minimum of five years and a maximum of thirty-two years prior to the exchange in 1961.

the exchange [R. 67-77]. On April 18, 1961, said 200,000 shares of Class A Stock were sold by said respondents to underwriters who resold said shares to the public as part of a public offering described in a registration statement filed pursuant to the Securities Act of 1933 (15 U.S.C. §§77A, *et seq.*) with the Securities and Exchange Commission and which became effective on April 11, 1961 [R. 121, 139]. During the period of less than six months between the dates of the exchanges of Common shares for Class A shares and the dates of the sales of Class A shares, there was substantial rise in the market price of the Class A shares.[7]

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[7]Contrary to Petitioner's assertion (Petition, p. 6) that the increase in the market price of Max Factor stock was extraordinary when compared to other comparable companies, the facts show this: A qualified expert showed that the prices of three comparable stocks increased at approximately the same rate as did the price of Max Factor over the period from December 1960 to April 1961. Mr. Levy, one of petitioner's counsel whose qualifications, if any, as an expert securities analyst are not contained in this record, shows that stock comparable in his opinion increased during the same period only 68.5%, 76.7%, 52.9%, and 44.1% [R. 133].

ARGUMENT.

The issue in the present case is narrow, and no amount of straining on the part of petitioner can convert it into a case warranting review by this Court on certiorari. The interpretation of Sections 16(b) and 3(a)-(13) of the Securities Exchange Act of 1934 by the Court of Appeals in this case are in accord both with applicable precedent, the language of the statute and the Congressional purpose and intent which prompted the enactment of Section 16(b).

Furthermore, the decision by the Court of Appeals for the Ninth Circuit in this case is not in conflict with the decisions of the Courts of Appeal in *Park & Tilford, Inc. v. Schulte* (2 C.A.), 160 F. 2d 984; *B. T. Babbitt, Inc. v. Lachner* (2 C.A.), 332 F. 2d 255; and *Booth v. Varian Associates* (1 C.A.), 334 F. 2d 1.

I.

The Decision Below Is Clearly Correct.

The court below, agreeing with the District Court, determined that the exchange of Common Stock for Class A Stock of the company in this case did not constitute a "purchase" within the meaning and intent of that term as used in Section 16(b). In reaching this conclusion, the court below in its opinion pointed out that the "statutory definitions of 'purchase' and 'sale' are exceedingly general * * *. They are given specificity by measuring questioned transactions against the purpose of Section 16(b). Thus, a transaction is held to be a 'purchase' within Section 16(b) 'if in any way it lends itself to the accomplishment of what the statute is designed to prevent.' *Blau v. Lehman*, 286 F. 2d 786, 792 (2d Cir. 1960), aff'd 368 U.S. 403 (1962)." (App. of Petition, p. 6).

When confronted with a case involving the acquisition of shares, the courts have determined whether it was a "purchase" within the meaning and intent of Section 16(b) by turning to the stated purpose of Section 16(b), viz., "preventing the unfair use of [inside] information," by determining whether the transaction, had the "economic indicia of a purchase" and was thereby one that "could have lent itself to the practices which Section 16(b) was enacted to prevent."[8]

In the *Ferraiolo*[9] case the defendant held convertible fixed-dividend preferred stock which had been called for redemption. He converted the preferred stock into common stock as permitted by the company's Certificate of Incorporation, and in less than six months be sold the common stock at a price higher than the market price of the stock on the date of the conversion. At the time of the conversion the redemption price of the preferred was less than the market price of the common into which it was convertible. It was thus apparent that the defendant, even though possessed with inside information, was in no better position than any other holder of preferred stock in determining whether to convert. If he failed to convert, he would receive the redemption price which was lower than the market price of the common shares into which it was convertible. Therefore, it was obvious to any preferred holder that he should convert rather than to accept the lower redemption price.

In the opinion by Judge (now Mr. Justice) Potter Stewart, the court held that the proper standard to be

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[8]*Ferraiolo v. Newman* (6 C.A.), 259 F. 2d 342, 346, *cert. den.* 359 U.S. 927.

[9]*Ferraiolo v. Newman* (6 C.A.), 259 F. 2d 342, *cert. den.* 359 U.S. 927.

applied was whether "the transaction is of a kind which can possibly lend itself to the speculation encompassed by Section 16(b)." (p. 345) The court then points out that under the circumstances the preferred and common shares were economic equivalents, that the conversion worked no material change in the proportional equity ownership of the company, and concluded:

> "Newman's conversion of Ashland preferred to Ashland common had none of the economic indicia of a purchase; it created no opportunity for profit which had not existed since 1948. The transaction was not one that could have lent itself to the practices which Section 16(b) was enacted to prevent." (p. 346)

For the same reasons, in this case, the date the Common shares were acquired by respondents many years earlier should be treated as the purchase date; and as concluded in its opinion by the court below, the making of the exchange, and its timing, were simply irrelevant to the use of insider information in short-term speculation—the problem with which Section 16(b) is concerned. If respondents acted upon inside information in disposing of their stock interest when they did, the exchange was unrelated to that fact—they could have done so quite as well, at exactly the same time, realizing precisely the same profit, without converting their Common to Class A at all. So also the nature, duration, and amount of their investment, the temptation and opportunity to trade on inside information, and the profit to be had by doing so, would all have been the same had the exchange been accomplished six months or more before the sale. In these circumstances, to hold that the exchange of Common for Class A

constituted a "purchase" within Section 16(b) would ignore the distinction which Congress drew between long-term investment and short-term speculation. (App. to Petition, p. 10).

In *Roberts v. Eaton* (2 C.A.), 212 F. 2d 82, the defendant family members owned substantially all of the stock of the corporation from 1917 until 1947 when they sold a portion of their stock to the public. In 1952, the family owned about 46% of the outstanding $5 par value common stock. In that year, the family decided to sell the remaining stock and determined that its marketability would be improved by reclassification. Accordingly, after approval by the stockholders of such reclassification, defendants surrendered their common stock in exchange for new common and new fixed dividend preferred. Within a month thereafter, they sold the common and preferred. The court held that the exchange did not constitute a "purchase" for 16(b) purposes.

Commenting on *Roberts v. Eaton,* Professor Louis Loss, in his definitive work on the Federal Securities Laws, observed:

> "This, indeed, does seem to be the theme commonly repeated throughout the entire line of unorthodox 'purchase' and 'sale' cases. It is of no more relevance than in routine cash transactions to consider whether inside information was in fact used. But it does seem to be of considerable consequence whether the circumstances were such that the defendant could possibly have obtained an advantage over the public generally which did not already exist. *Cessante ratione cessat ipsa lex.*"
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> 2 *Loss Securities Regulation* (1961), 1069-1070.

The generally understood meaning of "to purchase" is "to obtain by paying money or its equivalent; to buy for a price,"[10] or "to acquire something by one's own act or agreement for a price."[11] It involves parting with something of value or incurring some detriment. Neither occurs upon an exchange of the Common for Class A shares of the company, and thus such an exchange is not a *purchase* within its ordinary meaning. As detailed above (p. 7), the two classes have precisely the same rights and privileges except that a lesser (or no) dividend may be paid on the Common than on the Class A Stock. Thus, a shareholder who makes the exchange still possesses after the exchange every right which he had before the exchange. He has given up nothing. He has incurred no detriment. The only consequence of the exchange is to withdraw his authorization to the Board of Directors to declare a lesser, or no, dividend on his shares than on other shares. The two-class structure here involved is no different than one in which there is only one class of stock and some of the shareholders have given the corporation a waiver of dividends at the discretion of the Board of Directors, which waiver is revocable by the shareholder at any time. By his act of exchange of Common for Class A, a shareholder of the company simply terminates his pre-existing contingent waiver of dividends. Clearly, the revocation of such a waiver, pursuant to a right reserved in the waiver to do so, is not in any sense the acquisition of anything for a price and, accordingly, is not a *purchase*.

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[10] *Webster's New International Dictionary*, Unabridged, Second Edition, p. 2015.

[11] *Shaw v. Dreyfus* (2nd Cir. 1949), 172 F. 2d 140, 142, *cert. den.* 337 U.S. 907, 92 L. Ed. 1719.

Similarly, in the sense that the term *purchase* always contemplates the acquisition of something for a consideration, an acquisition of a share of Class A for a share of Common Stock is not comprehended within the term. Such a shareholder has lost absolutely nothing by terminating his pre-existing contingent waiver of dividends. As a holder of Class A Stock, he holds each and every right he held as a holder of the Common Stock.

The pertinent statute provides that ". . . unless the context otherwise requires—" the term "purchase" includes "any contract to buy, purchase, or otherwise acquire."[12]

Can it be said that the exercise of an exchange privilege embodied in the corporate charter constitutes a "contract to . . . acquire" made at the time of the exchange? A negative answer is required because the only contract to acquire was made when the common shares were purchased. Under the company's Certificate of Incorporation the holder of Common shares at the time he acquires such Common shares thereby possesses all the rights and privileges inherent in the Class A Stock and all rights to withdraw the contingent waiver of dividends at any time by exchanging his Common for Class A Stock. Thus, the "contract" is made when the Common shares are acquired and there is no contract made at the time of the exchange and no consideration is given at that time. The entire consideration was given at the time the shareholder acquired his Common Stock. The Common shareholder *purchases* the Class A Stock, in the sense of making a "contract to . . . acquire"

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[12]Securities Exchange Act of 1934, Section 3(a)(13), 15 U.S.C. Section 78c(a)(13), (App. to Petition, p. 1)

when he first acquires his shares of Common Stock. Here, respondents purchased their Common Stock in some cases as much as thirty-two years and in no case less than five years before the sale of the Class A Stock. (See f.n. 6 *supra*, p. 7.)

Basically, no *purchase* takes place if the shares exchanged are the economic equivalents of each other. That they are here is manifest, not only from the fact that the rights and privileges of the two classes of shares are identical with the sole exception of the contingent waiver of dividends evidenced by the Common, but also from the practical standpoint that in the market place there was no difference whatever since the purchaser of Common could immediately or at any time exchange it for Class A. In practice, and as pointed out by the court below (App. to Petition, p. 10), Common stock was acceptable to brokers to fill orders to sell Class A stock [R. 94-95].

Petitioner strives to create an alleged difference between the rights and privileges evidenced by the two classes of shares by asserting that the Class A Stock is, and the Common Stock is not, listed on a national securities exchange (Petition, p. 2).

It is true that the issued and outstanding Class A Stock of the company was listed on a national securities exchange [R. 3, 29, 14, 49]. It is also true that all shares of Class A Stock issuable upon exchange for outstanding shares of Common Stock on a share-for-share basis were at all times registered on such national securities exchange for listing thereon upon the giving to such exchange of official notice of issuance thereof [R. 14].

Since the holder of Common shares had an unrestricted right at all times to exchange his Common shares for Class A shares, which would automatically become listed, this can hardly be claimed to be a restriction on the marketability of the Common shares.

As pointed out by the court below, "the exchange was in reality only a step in the process of sale—and an unnecessary one at that, for Common was as marketable as Class A and at precisely the same price." (App. to Petition, p. 9).

The court below correctly pointed out that the only investment decision which was made by the individual respondents in the six-month period was the decision to terminate their long-term investment by sale to the public (App. to Petition, p. 9). The court below (App. to Petition, p. 10), further correctly considered the distinction which Congress made in enacting Section 16(b) between long-term investment, such as involved in this case, and short-swing trading which lends itself to abuse by insiders using inside information.[13]

The court below correctly concluded that the exchange in question was not a "purchase" within the purpose and meaning of Section 16(b) because "it did not increase or decrease the amount invested, or alter in any way the risk assumed long years before." (App. to Petition, p. 9).

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[13]See Stock Exchange Practices, Hearings before The Senate Committee on Banking and Currency, 73rd Cong., First Sess., pt. 15 at 6557-58 (1934).

II.

There Is No Conflict of Decision.

Petitioner asserts that the decision in the instant case is contrary to the decisions of the Court of Appeals in *Park & Tilford, Inc. v. Schulte* (2 C.A.), 160 F. 2d 984; *B. T. Babbitt, Inc. v. Lachner* (2 C.A.), 332 F. 2d 255 and *Booth v. Varian Associates* (1 C.A.), 334 F. 2d 1. This is incorrect.

In *Park & Tilford* the defendant had converted shares of fixed-dividend, redeemable, convertible preferred stock after that stock had been called for redemption and thereafter within six months had sold the common stock received upon the conversion. The court, without detailed analysis, asserted that a "purchase" had occurred on such conversion because defendant had not owned the common stock before the conversion but had owned it afterwards.

Even assuming that the conversion in *Park & Tilford* had sufficient "economic indicia of a purchase" so as to come within the ambit of the term as used in Section 16(b), the exchanges of Max Factor stock had no such indicia.

(a) In *Park & Tilford*, substantial differences in rights and privileges existed between the convertible fixed-dividend, redeemable preferred stock and the common stock. Most importantly, (i) the preferred was entitled to a first preference on liquidation and (ii) was subject to redemption thus subjecting the holder to the possibility of complete elimination of his interest in

the company. In the present case the rights and privileges of the two classes of stock are substantially the same.

(b) Not only was the preferred stock in *Park & Tilford* redeemable, but *it had in fact been called for redemption,* which made it both legally and practically necessary for the shareholder to elect within a limited period whether to convert or to be eliminated entirely as a shareholder by suffering redemption. This is a critical factor, for, being insiders, the defendants in those cases were in a position to use their inside information, if any, to make this necessary decision. Thus, if their inside information indicated a rise in the market price of the common, they would convert; otherwise, they would take the redemption price. Other shareholders would have to make this decision without the benefit of such information. In the instant situation, no right of redemption existed,[14] the Common could be exchanged at any time, and no amount of inside knowledge would enable an "insider" to determine any better than any other shareholder a profitable time to make an exchange. The *making* of the exchange or the time it was made would have *no* effect on the profit realized.

(c) The defendant shareholders in *Park & Tilford* had a different proportional interest in the issuer be-

[14]Petitioner strains desperately for a parallel between this case and *Park & Tilford* by asserting that the Class A shares are clothed "with all the attributes of a 'Callable Preferred' stock". (Petition, p. 5) This is totally wrong. The central characteristics of a callable preferred are that the company has a legal right to buy the stock from the shareholder at a price (the redemption or call price) agreed upon in advance and thus can, by calling the stock, completely eliminate the holder's interest as a shareholder. Here, a resolution changing the Class A shares to Common shares would leave each holder with exactly the same rights and privileges, as a holder of the one class of Common shares then outstanding, as he had before the change. Far from having "all the attributes of a 'Callable Preferred' ", the Class A shares have none of such attributes.

fore and after the conversion of preferred (with fixed dividend, fixed redemption, and fixed liquidation rights) into common (with all the residual dividend and liquidation rights). In the Max Factor situation the proportional interests were identical before and after the exchange of Common for Class A.

The court below considered Petitioner's argument that *Park & Tilford* is controlling in this case and distinguished that case as follows: "The preferred and common exchanged in *Park & Tilford* involved significantly different investment risks. For this and other reasons, the decision to exchange the convertible security required an investment decision within the six months' period distinct from the decision to sell the converted security—a new investment risk was undertaken, and a new, if limited, opportunity was presented to realize profit, or avoid loss, through the use of insider information" (App. to Petition, p. 11).

In the *Babbitt*[15] case, the Court of Appeals' abrupt conclusion (p. 258) "that a conversion of preferred into common is a 'purchase' within the meaning of §16(b)," citing the *Park & Tilford* case is dictum because the court concluded that no profit existed on any transaction involving the conversion of the Series "B" Preferred Stock into common. Moreover, there is nothing in the opinion which would indicate what the relative rights and privileges of the Series "B" Preferred Stock, and the Common were other than the statement (p. 258) that Series "B" Preferred, unlike Common, had no market. In this respect, the *Babbitt* case is clearly distinguishable from the instant case where the Common does have a ready market

[15] *B. T. Babbitt, Inc. v. Lachner* (2 C.A.), 332 F. 2d 255.

(*supra*, p 15). In short, the *Babbitt* case is clearly distinguishable and any alleged conflict between the decision in that case and the decision in the court below is illusory.

In the *Booth*[16] case, the Court of Appeals was concerned with the question whether the acquisition of shares in 1962 pursuant to a binding executory agreement entered into in 1959, was a "purchase" in 1962 for the purpose of Section 16(b). The Court of Appeals concluded that the acquisition of the shares in 1962 was a "purchase" for the purpose of Section 16(b). The fact situation in that case is not comparable to this case[17] nor is the rationale of the *Booth* opinion in conflict with the decision in the court below.[18] In fact, the Court of Appeals in the *Booth* case stated that both sides had relied to a great extent upon cases concerned with the application of Section 16(b) to options, warrants, conversions and like transactions and referred, among other things, to *Roberts v. Eaton* (discussed *supra* at p. 12) and the *Park & Tilford*

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[16]*Booth v. Varian Associates* (1 C.A.), 334 F. 2d 1.

[17]The defendants in *Booth* sold their shares of Bomarc to Varian in 1959 in return for a promise by Varian to deliver Varian shares in 1962 based on the 1962 market price for Varian stock. The question was not whether the acquisition of the Varian shares was a "purchase" but when did the "purchase" take place, *i.e.*, 1959 when the agreement was entered into or 1962 when the number of shares was fixed and the shares were delivered.

[18]The decision in the *Booth* case is based to a large extent on the argument that the use of a 1959 purchase date would perhaps bar any recovery under the applicable statute of limitations. Moreover, the *Booth* opinion is based on the rationale that since the price per share was not fixed until 1962, no short-swing speculation could have taken place in 1959 with respect to the shares to be acquired by defendants under the 1959 agreement. *Booth v. Varian Associates* (1 C.A.), 334 F. 2d 1, 4-5.

case (discussed *supra* at p. 17). The court in the *Booth* case concluded that "we do not believe cases of the classes referred to, involving problems peculiar to their own types of transactions, are especially helpful in deciding the case before us." The Petitioner's attempt to rely on the *Booth* case as authority contrary to the decision of the court below in this case is similarly unhelpful to this court.

III.

There Is No Important Question of Federal Law Involved.

Petitioner misstates the impact and rationale of the decision below in an attempt to convince this Court that the decision below has a wider impact on the application of Section 16(b) than it actually has. Petitioner states that "under the rationale of the decision below, every acquisition of an issuer's security by an insider through his exercise of an option or conversion of stock would automatically be excluded from the operation of the statute where the insider has owned such option or convertible security for more than six months." (Petition, p. 11). The court below has not, in any way, purported to state that every acquisition of stock by an insider through the exercise of an option or conversion of stock held for more than six months would automatically be excluded from the operation of the statute. The decision of the court below is based upon the fact that the Class A and Common Stock of the company are virtually identical and the "exchange of Class A for Common did not interrupt the continuity of appellees' investment: it did not increase or decrease the amount invested, or alter in any way the risk assumed long years before." (App. to

Petition, p. 9). The exercise of an option (involving typically the payment of cash or a promissory note in return for stock) results in a substantial change in the investment risk undertaken by the optionee and, for that reason, it is not akin to the exchange of Max Factor Common Stock for Class A Stock. The opinion of the court below is clearly limited in its applicability to the type of transaction where the exchange of shares is a matter of form rather than substance (See App. to Petition, footnote 13, on pages 9-10). As such, the decision below is not only correct, but clear, and the question involved, while of substantial importance to the parties, is limited and does not involve a question with which this Court should concern itself.[19] As pointed out above, the opinion below is not in conflict with the opinions referred to by Petitioner on page 12 of the Petition and it does not render uncertain the enforcement of Section 16(b) of the Securities Exchange Act of 1934.

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[19]Moreover, a decision by this Court on the issue presented by the Petition would not dispose of the case or the legal issue of the applicability of Section 16(b) to an exchange of the type here in question, for, as mentioned *supra*, at page 4, the District Court found that the exchange in question was exempted by Rule 16b-9 of the Securities and Exchange Commission [R. 143, 144]. The Court of Appeals expressly declined to reach that question since it concluded that the exchange was not a "purchase" under the Statute (App. to Petition, p. 6). In these circumstances, a reversal by this Court would result in a remand to the Court of Appeals to review the District Court's decision concerning Rule 16b-9 and the issue of the applicability of Section 16(b) to an exchange of the Max Factor type would remain.

Conclusion.

For the foregoing reasons, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

GIBSON, DUNN & CRUTCHER,
HERBERT F. STURDY,
FREDERIC H. STURDY,
SAMUEL O. PRUITT, JR.,
RUSSELL L. JOHNSON,
By FREDERIC H. STURDY,

Counsel for Respondents, Davis Factor, Louis Factor, Max Factor, Jr., Sidney Factor, Chester Firestein, Max Firestein, Freda F. Shore, Anna Factor, Doris Factor, Dorothy Factor, and Cecilia Firestein.

APPENDIX.

Excerpt From Certificate of Incorporation of Max Factor & Co. Setting Forth the Rights and Privileges of the Common Stock and Class A Stock.

FOURTH: The total number of shares of all classes of stock which the corporation is authorized to issue is fourteen million (14,000,000). All such shares are to have a par value of one dollar ($1.00) and are to be divided into two (2) classes to be known, respectively, as "Class A Stock" and "Common Stock." The number of shares of Class A stock shall be ten million (10,000,000) and the number of shares of Common stock shall be four million (4,000,000).

The designations and the powers, preferences and rights, and the qualifications, limitations and restrictions thereof, of the various classes of stock of the corporation are as follows:

Commencing April 1, 1958, and with respect to each quarterly period commencing on the first day of April, July, October and January in each year, the holders of Class A Stock shall be entitled, when and as declared by the Board of Directors, to dividends at such rate as may be determined by the Board of Directors payable in preference and priority to any payment of any dividend on shares of Common Stock. After a dividend with respect to any quarterly period has been so paid or declared and set apart for payment on the Class A Stock, a dividend for such period may be paid or declared and set apart for payment on each share of Common Stock equal to or less than such dividend on each share of Class A

Stock for the same quarterly period. The right to such dividends shall not be cumulative and no right shall accrue to any holder of either class of stock by reason of the fact that dividends on said shares are not paid with respect to any quarterly period.

The holders of stock of each class shall be entitled to one (1) vote for each share of stock held by them and voting shall not be by separate classes except where specifically so required by law.

Common Stock at the election of the holders thereof may be exchanged share for share for Class A Stock at any time prior to but not on or after a date which may be specified by resolution of the Board of Directors as the date on or before which the Class A Stock must be exchanged share for share for Common Stock as hereinafter provided.

At any time on or after January 1, 1950, the directors may, by resolution, require that the Class A Stock be exchanged share for share for Common Stock on or before a date specified by the directors, which date shall be not earlier than ten (10) days and not later than forty (40) days after the mailing of notice of the adoption of such resolution to the holders of record of Class A Stock, directed to them at their respective addresses for Notice of Stockholders' Meetings in accordance with the by-laws of the corporation. The holders of Class A Stock shall surrender their certificates therefor to the corporation on or before said date and shall receive in exchange therefor certificates for a like number of shares of Common

Stock. The issued number of shares of Common Stock shall be increased by the number of Class A shares exchanged. After said date the shares of Class A Stock shall not be deemed to be outstanding for any purpose whatsoever and the respective holders thereof shall have no further rights or claims against the corporation, except the right to surrender their certificates and to receive in exchange certificates of Common Stock, together with an amount equal to any dividends which may have been declared on the Common Stock to holders of record of the Common Stock on or after the date specified by the Board of Directors for exchange of Class A Stock for the Common Stock.